FESE Response to the Consultation on the Technical Expert Group's draft technical advice on minimum requirements for the EU climate-transition benchmarks and the EU Paris-aligned benchmarks and benchmarks' ESG disclosures

Brussels, 31st July 2019

1.1 Overall ESG disclosures

Q1: The TEG believes that the sustainability disclosure requirements for all benchmarks in the methodology and in the benchmark statement should be distinguished by type of asset classes. Do you agree with this approach?

Yes ☒
No ☐
Don't know/ no opinion/ not relevant ☐

Q2: Do you believe that non-significant benchmarks should disclose less information than significant benchmarks, in line with the proportionate approach set out in the benchmark regulation (Regulation (EU) 2016/1011)?

Yes ☒
No ☐
Don't know/ no opinion/ not relevant ☐

Q3.a: The TEG has identified different types of KPIs of the benchmarks for the respective asset classes (see Section 3 of the TEG report on climate benchmarks and ESG benchmarks' disclosures - 'the Report' - Annex I to VII).
On a scale from 1 to 5, please express your view as to the level of indication for the suggested KPIs for the respective asset class of benchmarks (1 indicating the lowest level of satisfaction regarding the KPIs):

	1 (lowest level of satisfaction)	2	3	4	5 (highest level of satisfaction)	Don't know / no opinion / not relevant
Equities (annex I)		x				
Fixed Income - Corporates and Securitised (ABS) (annex II)			x			
Fixed Income - SSA (annex III)			x			

Commodities (annex IV)			x			
Infrastructure (annex V)			x			
Private Equity, Private Debt, Infrastructure (annex VI)	x					
Hedge Funds (annex VII)						x

Q3.b: Please indicate any KPI(s) you would not favor to include from the KPIs listed in section 3 of the Report:

Required ESG disclosures should be limited to metrics measuring index exposure to companies failing global norms and standards or whose activities are contrary to the objectives of these norms and clearly specified standards (as GHG ones).

In addition, we do not agree that the requirements for private equity and debt should differ from those applicable to listed securities. Given the ultimate purpose of ESG reporting is to instill sustainable practices universally, ESG disclosure expectations for these securities should be the same irrespective of whether they are public or private.

Please also see answer to Q10 below.

Q3.c: Please indicate any KPI(s) you would recommend to add to the KPIs listed in section 3 of the Report:

N/A

Q4: Do you agree with the mandatory disclosure of ESG ratings for equity and fixed-income benchmarks

Yes ☒
No ☐
Don't know/ no opinion/ not relevant ☐

Q5: If relevant, please explain the impact of the disclosure of ESG ratings for equity and fixed income benchmarks on you, especially in terms of the costs and benefits implied:

This proposal will impact production costs of indices (due to the acquisition of additional ESG data or services from external data provider) without necessarily improving tools for decision, due to the fact that ESG disclosure may differ from one benchmark administrator to another in the absence of public norms and clearly specified standards.

Q6.a: The TEG has drawn up templates for the disclosure of ESG information in the benchmark statement and in the methodology (see templates 1 and 2 in Appendix D of the Report)
On a scale from 1 to 5, please express your view regarding the format of these templates (1 indicating the lowest level of satisfaction regarding the format):

1 ☐
2 ☐
3 ☐
4 ☒
5 ☐
Don't know/ no opinion/ not relevant ☐

Q6.b: Would you have any suggestions to improve the format of the templates?
N/A

Q6.c: On a scale from 1 to 5, please express your view as to the cost of producing these templates (1 indicating the lowest level of cost of implementation)
1 ☐
2 ☐
3 ☐
4 ☒
5 ☐
Don't know/ no opinion/ not relevant ☐

Q7: Do you agree that the template for ESG factors in the benchmark statement should be updated at least on a quarterly basis?
Yes ☐
No ☒
Don't know/ no opinion/ not relevant ☐

If you responded "no" to question 7, what update frequency would you prefer? Do you have any further comments?
In order to limit the cost related to this, and considering the fact that ESG data is generally reported on a yearly basis, we would recommend an annual update would be more appropriate.

Q8: Do you agree with the disclosures on overall degree of alignment with the objectives of the Paris Climate Agreement (template 3 in Appendix D)?
Yes ☒
No ☐
Don't know/ no opinion/ not relevant ☐

Q9: Do you think that the CTB & PAB should disclose more information requested in section 4.1 of the Report?
Yes ☐
No ☒
Don't know/ no opinion/ not relevant ☐

Q10: What is the overall impact of the above technical advice on ESG disclosures, especially in terms of costs to benchmark administrators and benefits to investors? Please provide clear indication to which stakeholder your answer belongs.
FESE welcomes the increased transparency for customers as lined out in Annex D, while we anticipate that the proposals made by the TEG will most likely result in additional cost for Benchmark Administrators.

Such costs may arise from Benchmark Administrators having to acquire additional data from data vendors or the outsourcing of ESG transparency calculations to third party service providers, but also from overly frequent updates of benchmark statements (e.g. as proposed per quarter). While we support transparency for investors, we would propose to not require quarterly updates of benchmark statements, as it would add heavily on cost and not provide a lot of additional value. Alternatively, we would propose to link the update of the benchmark statements with the review frequency of the methodology of benchmarks.

Nevertheless, FESE believes that transparency towards investors could be enhanced additionally without additional cost by defining the ESG minimum disclosure requirements on a more detailed level in the context of supporting standards and specifications. The TEG Report mentions several “supporting standards and specifications” in order to give benchmark administrators points of departure for their approach to the minimum disclosure requirements as set out in the minimum disclosure requirement tables in Annex D. Yet, the Benchmark Administrator has to choose the respective approach and disclose it. Only in individual cases, does the TEG Report make a reference to a clearly specified standard (as GHG accounting standards GHG Protocol or ISO that may be used for equity benchmarks).
Based on the proposals in the TEG Report, ESG data and methodological approach regarding ESG disclosure will differ from Benchmark Administrator to benchmark administrator – potentially even from benchmark (family) to benchmark (family), cp. Artt. 13(1)(a) and 27(1) first subpara BMR. This means that the ESG characteristics of indices disclosed by one administrator will not be immediately comparable to the ESG characteristics of indices disclosed by another administrator.

In this situation, which will be highly unsatisfactory for investors, investors will try to obtain comparability of ESG disclosures by putting pressure on smaller Benchmark Administrators to adapt to the standards used by bigger Benchmark Administrators. This would amount to the biggest players in the market and not the legislator defining the standards.

In particular, regulation should specify which exact standards should be used by Benchmark Administrators in order to disclose the ESG characteristics of their benchmarks.

Please note that this comment relates to ESG minimum disclosure requirements only and not to benchmark methodologies. In order not to infringe on the variety of benchmarks in the market and competition amongst Benchmark Administrators, there should not be any further restrictions on the methodological approach a Benchmark Administrator uses for its benchmarks; other than the standardization intended by creating the benchmark types CTB and PAB.

Q11: Do you see a need for guidance from the TEG on ESG data related charges similar to what is set out in the shareholder rights directive II.

Yes ☐

No ☒

Don’t know/ no opinion/ not relevant ☐

1.2 Methodology of the climate benchmarks

Q12: Do you think the CTB and the PAB differ methodology-wise sufficiently from each other?

Yes ☐

No ☒

Don’t know/ no opinion/ not relevant ☐

Comments:
See our answer to questions 13.b below.

Q13.a: Please express your agreement with the proposed minimum requirements for CTB.
Use the scale from 1 to 5 (with 1 indicating no agreement):

	1 (no agreement)	2	3	4	5 (full agreement)	Don't know / no opinion / not relevant
Minimum Scope 1+2(+3) carbon intensity reduction of 30 % compared to investable universe		x				
Scope 3 phase-in (2 - 4 years)	x					
The green brown share ratio shall at least be equivalent to the green share/brown share ratio of the investable universe			x			
Minimum exposure to sectors highly exposed to climate change issues is at least equal to market benchmark value	x					
At least 7% of annual decarbonisation: in line with or beyond the decarbonisation trajectory from the IPCC's 1.5°C scenario (with no or limited overshoot)		x				

Q13.b: Please provide any comments on recommended changes or additions to the minimum requirements listed in question 13.a:

FESE is of the opinion that the two Benchmarks as currently proposed do not sufficiently differ from each other. We therefore propose to make the following additional distinctions (changes to Table 1, minimum standards of EU CTBs and EU PABs):

1. EU CTB scope 3 phase in of 5 – 10 years, while EU PAB scope 3 phase in could be remain as proposed (2 – 4 years).
A prerequisite for phasing in scope 3 would be the market-wide availability of scope 3 data. However, such data is not available in sufficient quality and quantity as of today. On this topic, the TEG Report states on p. 53: "The TEG is also hopeful that Scope 3 data, at least upstream, become of high quality within a decade.". Scope 3 data should only be phased in, once it can be ensured that such data is available in sufficient quality and quantity. Before phasing it in, it should be assessed by ESMA whether the data required is available in sufficient quality and quantity.

2. Year-on-year self-decarbonization of the benchmark: at least 5% for CTB and 8% for PAB. Further differentiation between CTB and PAB is sensible so that the categories offer a true choice to investors and can fulfil their intended roles (i.e. EU PAB for highly ambitious climate-related investment strategies and are characterized by stricter minimum

requirements and EU CTB to allow for greater diversification and serve the needs of institutional investors in their core allocation).

3. Disqualification from label for EU CTB only if 3 consecutive years of misalignments with trajectory or 4 misses in 10 years. To further differentiate between CTB and PAB, this criterion should be less strict for EU CTB.

In addition, a withdrawal of label could have disruptive effects for a benchmark administrator. The use of a benchmark would drop drastically, once the label has been removed. This could even lead to a divestment in products referencing such benchmark.
Further, the benchmark administrator can only assess the alignment of an index with a trajectory ex-ante. It is not part of the benchmark administrator's responsibility if constituents of an index miss the expected alignment. However, this may lead to the index missing the trajectory target. Benchmark administrators would probably address such potential consequences by creating a buffer for such cases where constituents of an index miss the expected alignment. This would result in benchmark administrators having to exceed the requirements. This effect will be exacerbated if the trajectory target was missed once.

Q14.a: Please express your agreement with the proposed minimum requirements for PAB. Use the scale from 1 to 5 (with 1 indicating no agreement):

	1 (no agreement)	2	3	4	5 (full agreement)	Don't know / no opinion / not relevant
Minimum Scope 1+2(+3) carbon intensity reduction of 30 % compared to investable universe	x					
Scope 3 phase-in (2 - 4 years)	x					
The green brown share ratio shall at least be equivalent to the green share/brown share ratio of the investable universe						x
Minimum exposure to sectors highly exposed to climate change issues is at least equal to market benchmark value	x					
At least 7% of annual decarbonisation: in line with or beyond the decarbonisation trajectory from the IPCC's 1.5°C scenario (with no or limited overshoot)		x				

Q14.b: Please provide any comments on recommended changes or additions to the minimum requirements listed in question 14.a:
Please see our answer to question 13.b above.

Q15: Do you think that it would be relevant to extend the minimum requirements to sovereign indices?
Yes ☐
No ☒
Don't know/ no opinion/ not relevant ☐

Q16: Do you believe that the requirement set out in the amending regulation (article 23a) for CTB & PAB to select, weight or exclude underlying asset that follow a decarbonisation trajectory should be further clarify in a minimum requirement?
Yes ☒
No ☐
Don't know/ no opinion/ not relevant ☐

Q17: Do you think the scenario selected to drive the decarbonisation trajectory - IPCC 1.5° with no or limited overshoot - is the most appropriate one?
Yes ☒
No ☐
Don't know/ no opinion/ not relevant ☐

Q18: Do you think the minimum standards suggested in the report leave enough flexibility for market players to further innovate in the field of climate indices aligned with ambitious climate trajectories?
Yes ☒
No ☐
Don't know/ no opinion/ not relevant ☐

Q19: Do you agree having different denominators (e.g. total capital, revenue) for the calculation of the GHG intensity depending on the use case (table 6 in Section 5.3.3. in the Report)?
Yes ☐
No ☒
Don't know/ no opinion/ not relevant ☐

If you responded "no" to question 19, please provide any further comments and/or suggestions:
We do not think that changing the current market standard (million USD of revenue) would be beneficial. To the contrary, such change would cause large-scale inefficiencies.

Q20: Do you believe that the definition of total capital (i.e. 'the sum of the book values of common stock, preferred equity, long term debt and minority interest') for the calculation of the GHG intensity is accurate?
Yes ☐
No ☒
Don't know/ no opinion/ not relevant ☐

If you responded "no" to question 20, please provide any further comments and/or suggestions:

We do not think that changing the current market standard (million USD of revenue) would be beneficial. To the contrary, such change would cause large-scale inefficiencies.

Q21: What is the overall impact of the technical advice on CTBs and PABs, especially in terms of costs to benchmark administrators and benefits to investors?
N/A

Q22: Do you see merits in further aligning the proposed benchmarks methodologies with the principles of the taxonomy once the latter is approved?
N/A

Should you wish to provide additional information (e.g. a position paper, report) or raise specific points not covered by the questionnaire, you can upload these.
It seems that certain users of benchmarks such as product issuers and the pension funds industry seem to be under-represented in the working group; in our view they would bring valuable points of view on ESG data, analytics and reporting requirements.

Finally, we believe that the disclosure requirements should not be differentiated on the basis of whether the security is listed or not, as the same requirements should apply to both categories. There is a risk that should such a distinction be made, it would act as a disincentive to listing and result in overall decreased transparency.